STATE BOARD OF EQUALIZATION **570.0225**

Preliminary Hearing

Report of Hearing Officer George A. Trigueros (June 9, 1960)

Taxpayer:
--- --- & --- Corporation
Canning Machinery Division
XXX West --- Street
--- ---, California

Account No. - - XXXX1
Form No. 432
Date of Billing 10-31-58
Period (From 7-1-55 (To 6-30-58

Date of Hearing Thurs., Nov. 5, 1959 Time 11:00 a.m. Place --- ---

Appeared on behalf of Petitioner:

Mr. F. ---, Secretary-Treasurer

Mr. P. ---, Jr., Attorney

S. B.E. Representatives: Mr. J. Manarolla

Comment and Recommendations:

Protested Items:	Measure State	Measure Local
Cost of materials purchased for resale used in manufacturing and reconditioning machinery leased out-of-State	$126,714.73	$99,532.09

Contentions of Petitioner:

That it has properly purchased the materials ex tax - - that under Section 6009.1 materials are not subject to use tax.

Report on Facts:

Taxpayer manufactures food processing machinery. It leases such machines to food processors, both in this State and out. Taxpayer purchases the materials ex tax. However, it reports tax only on the cost of materials which are used in manufacturing machines which are subsequently leased inside this State. Taxpayer does not report use tax on materials which are used in manufacturing machines which are leased outside the State.

It is taxpayer's contention that it has properly purchased the material ex tax and that, since the machines leased out-of-State never are returned, the cost of materials is not subject to use tax, because of the exclusion provided in Section 6009.1.

It is taxpayer's contention that its exercise of dominion over such materials is solely for the purpose of fabricating it into other tangible personal property to be transported outside the State and is thereafter used solely outside the State. Therefore, taxpayer asserts its use of such materials comes squarely with the terms of the exclusion provided in Section 6009.1.

Auditor Manarolla found that the materials were purchased for individual machines at a time when it was known that the particular machines would be leased in the State or outside the State. Since taxpayer knew which machines would be leased out-of State, it was the auditor's belief that taxpayer could not validly purchase such materials ex tax under resale certificate.

Taxpayer contended that Section 6009.1 was applicable in this case. It provides:

> "'Storage' and 'use' do not include the keeping, retaining or exercising any right or power over tangible personal property for the purpose of . . . being processed, fabricated, or manufactured into, attached to or incorporated into, other tangible personal property to be transported outside the State and thereafter used solely outside the State."

Taxpayer points out that, on the basis of the foregoing Section, the use tax does not apply to materials purchased out-of-State which become incorporated in machinery leased out-of-State. Taxpayer argued that, since the words "shipped or brought into this State" were eliminated from the statute as of July 1, 1953, all materials and components purchased for use in the manufacture of machinery leased to out-of-State customers are exempt.

In support of its position, taxpayer cited an abstract of a letter ruling by Mr. E. H. Stetson, dated December 8, 1955:

> "Neither the sales nor use tax applies to the cost to the lessor of component parts used in the manufacture of equipment for subsequent leasing outside this State, where the parts were purchased either outside this State or in this State under a valid resale certificate, as to equipment delivered to the out-of-State lessee and not returned to this State and used here for at least six months after the original out-of-State delivery."

Inasmuch as all the materials and components in question were purchased under resale certificates and the equipment was not returned to California after being leased out-of-State, it is taxpayer's contention that this ruling supports its contention.

The foregoing digest was derived from a statement made by Mr. E. H. Stetson, Tax Counsel, in a letter to Latham & Watkins. The original question was, where a manufacturer of electronic instruments, which are leased and sold both in and out of California, purchases components under resale certificate not knowing at the time whether the particular part purchased will be used in equipment which will be leased or sold, does use tax apply to the cost of component parts?

It was Mr. Stetson's opinion that neither the California sales nor use tax was applicable to the cost of component parts used in the manufacture of equipment for subsequent leasing outside this State purchased in this State under a resale certificate validly given when the equipment was delivered to an out-of-State lessee.

Conclusions:

Inasmuch as taxpayer knew at the time that it purchased the materials that such materials would not be resold, taxpayer could not validly give a resale certificate.

Therefore, taxpayer cannot bring itself within the exclusion from use tax by virtue of the wrongful act under which it became liable for payment of the use tax.

Recommendation:

That the petition be denied.

GAT:o'b

Approved:

_____ _____
Tax Counsel Date

_____ _____
Principal Tax Auditor Date